



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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4942.00-00; 4942.03-05; 4945.04-00;
4945.04-05

Contact Person:
Identification Number:
Telephone Number:
Employer Identification Number:

Legend:

Project =

Dear

This is in response to your letter dated March 23, 2012 in which you requested certain rulings with respect to §§ 501(c)(3), 507, 4941, 4942, and 4945 of the Internal Revenue Code ("Code").

Background:

You have been recognized as an organization described in § 501(c)(3) and classified as a private foundation under § 509(a). Your charitable purposes are to receive and administer funds for religious, charitable, scientific, and educational purposes. You make grants from your investment income. You also own real property that was previously used for your exempt purpose when you met the qualifications to be a private operating foundation. This property is now in disrepair and is little used by you. Money used to maintain this property takes away from funds you could use to make grants in furtherance of your charitable purpose.

Your founders, which are also part of your directors, have founded another organization that has submitted a Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. You expect the new organization, Project, to be exempt under § 501(c)(3) and classified as a private operating foundation under § 509(a). Project will operate a facility that will be used as an artist-in-residence program for emerging artists and will also provide the artists with needed supplies. It is expected that Project will be able to use the real property in furtherance of its exempt purpose operations. The real property consists of four parcels of land, two of which have single family residences on them while the other two are unimproved parcels. One of the two improved parcels contains a single family residence, as does the other improved property, and it is also improved with a guest apartment and an outbuilding suitable for an art studio or exhibition space.

You anticipate giving your real property as well as other personal property held by you to Project. The value of the real and personal property you will provide to Project was appraised within a month prior to submitting this ruling. The value of the real and personal property as of that appraisal exceeds twenty-five percent of the total value of your assets as of that date. Additionally, the value of the items you are giving to Project exceeded twenty-five percent of the total value of your assets as of the filing of your last 990-PF. You also intend to provide grants to Project in the future as part of your regular grant making.

Project will be operated and controlled by the same directors and officers who control you.

You state that you have not and will not notify the Internal Revenue Service of your intent to terminate your status pursuant to § 507(a)(1). You further state that you have *never either willfully repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under chapter 42*. You also state that currently and at the time of the proposed distribution of assets from you to Project, there are not and will not be any willful repeated act (or failure to act) or willful flagrant act (or failure to act) which would give rise to liability for taxes under chapter 42. You also represent that you have no expenditure responsibility grants outstanding under § 4945(h).

Rulings Requested:

1. The proposed transfer will not affect your tax-exempt status under § 501(c)(3).
2. The proposed transfer will qualify as a transfer described in § 507(b)(2). Further, Project will not be treated as a newly created organization for purposes of Part II, Subchapter F, Chapter 1 of the Code and will succeed to your aggregate tax benefits and tax liabilities in proportion to the assets transferred pursuant to §§ 1.507-3(a)(2) and (4).
3. The proposed transfer will not cause a termination of your private foundation status under § 507.
4. The proposed transfer will not constitute a taxable expenditure within the meaning of § 4945, provided you exercise the limited form of expenditure responsibility required by § 53.4945-5(c)(2) with respect to the gift and each grant.
5. The proposed transfer will not constitute an act of self-dealing prohibited by § 4941 as to your founders, your directors and officers, or Project.
6. The legal, accounting, and other expenditures incurred by you to effectuate the proposed transfer will not be treated as taxable expenditures under § 4945.

Law:

Section 501(c)(3) of the Code provides that organizations may be exempted from tax if they are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 507(a) of the Code provides that the status of any organization as a private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination, or there have been willful and repeated acts, or a willful and flagrant act, giving rise to liability for tax under chapter 42, and the Secretary notifies such organization that it is liable for such tax.

Section 507(b)(2) of the Code provides that for purposes of §§ 507, 508, and 509 in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code defines self-dealing as the furnishing of goods, services, or facilities between a disqualified person and a private foundation as well as the payment of compensation by a private foundation to a disqualified person.

Section 4942(a) of the Code imposes a tax on undistributed income of a private foundation for any taxable year, which has not been distributed by the first day of the second taxable year following such taxable year.

Section 4942(c) of the Code defines undistributed income as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time out of such distributable income.

Sections 4942(d) and (e) of the Code define distributable amount as an amount equal to five percent of the excess of the fair market value of all assets of the foundation over its acquisition indebtedness for such assets minus the sum of the taxes imposed on such foundation for the taxable year under § 4940.

Section 4942(g)(1) of the Code defines qualifying distribution as any amount (including that portion or reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to an organization controlled by the foundation or one or more disqualified person with respect to the foundation, except as provided in § 4942(g)(3).

Section 4942(g)(3) of the Code provides that the term qualifying distribution includes a contribution to a § 501(c)(3) organization controlled by the foundation or one or more disqualified persons with respect to the foundation if not later than the close of the first taxable year after the taxable year in which such contribution is received such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution, and the private foundation make the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described above has been made by such organization.

Section 4945(a) of the Code imposes a twenty percent tax on each taxable expenditure of a private foundation.

Section 4945(d) of the Code defines taxable expenditure as any amount paid or incurred by a private foundation as a grant to an organization unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h) or an amount paid for any purpose other than one specified in § 170(c)(2)(B).

Section 4945(h) of the Code defines expenditure responsibility as the private foundation will assert all reasonable efforts and establish adequate procedures to see that the grant is spent solely for the purpose for which it was made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 4946(a)(1) of the Code provides that a "disqualified person," with respect to a private foundation, includes a substantial contributor, as defined under § 507(d)(2), a foundation director or officer, and any spouse, ancestor, child, grandchild, great grandchild, of that contributor, director, or

officer.

Section 1.501(c)(3)-1(c)(1) of the regulations states an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.507-3(a)(2) of the Income Tax Regulations ("regulations") provides that a transferee organization to which § 507(b)(2) applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market value of the assets transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor immediately before the transfer.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under chapter 42 prior to, or as a result of, making a § 507(b)(2) transfer to one or more private foundations, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor does not satisfy such liability.

Section 1.507-3(a)(5) of the regulations provides that a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g).

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled by the same person or persons which effectively controlled the transferor private foundation such a transferee foundation shall be treated as if it were the transferor.

Section 1.507-3(c) of the regulations provides that for the purposes of § 507(b)(2) the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term significant disposition of assets shall include any disposition for a taxable year where the aggregate of the dispositions to one or more private foundations is twenty-five percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations states that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Section 53.4941(d)-2(f)(2) of the regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing. Thus, the public recognition a person may receive, arising from the charitable activities of a private foundation to which such person is a substantial contributor, does not in itself result in an act of self-dealing since generally the benefit is incidental and tenuous. For example, a grant by a private foundation to a section 509(a) (1), (2), or (3) organization will not be an act of self-dealing merely because one of the section 509(a) (1), (2), or (3) organization's officers,

directors, or trustees is also a manager of or a substantial contributor to the foundation.

Section 53.4942(a)-3(c)(2) of the regulations provides that for a donee organization to meet the distribution requirements under § 4942(g)(3) it must not later than the close of their taxable year after its taxable year in which any contributions are received, distribute an amount equal in value to the contributions received in such prior taxable year and have no remaining undistributed income for such prior taxable year.

Section 53.4945-5(c)(2) of the regulations provides that if a private foundation makes a grant to a private foundation for endowment, for the purchase of capital equipment, or for other capital purposes the grantor foundation shall require reports from the grantee on the use of the principal and the income from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years.

Section 53.4945-5(d)(1) of the regulations provides that to satisfy the report making requirements of § 4945(h)(3), a granting foundation must provide the required information on its annual information return for each taxable year which is subject to the expenditure responsibility requirements of § 4945(h).

Section 53.4945-6(b)(1)(v) of the regulations provides that any payment which constitutes a qualifying distribution under § 4942(g) or an allowable deduction under § 4940 will not ordinarily be treated as taxable expenditures under § 4945(d)(5).

Section 53.4945-6(c)(2) provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 53.4945-6(c)(3) of the regulations provides that if a private foundation transfers assets as described in § 507(b)(2), the transferred assets will not be considered used exclusively for purposes described in § 170(c)(2)(B) unless the assets are transferred to a fund or organization described in § 501(c)(3).

Section 53.4946-1(a)(8) of the regulations provides that for purposes of § 4941 only, the term "disqualified persons" shall not include any organization which is described in § 501(c)(3) (other than organizations described in § 509(a)(4)).

Rev. Rul. 64-182, 1964-1 C.B. 186, provides that corporation organized exclusively for charitable purposes derives its income principally from the rental of space in a large commercial office building which it owns, maintains, and operates. The charitable purposes of the corporation are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. The ruling holds that the corporation is deemed to meet the primary purpose test of § 1.501(c)(3)-1(e)(1) of the regulations, and to be entitled to exemption under § 501(c)(3) of the Code, where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

Rev. Rul. 2002-28, 2002-1 C.B. 241, provides, "A transfer of assets described in § 507(b)(2) does not constitute a termination of the transferor's private foundation status under § 507(a)(1) unless the transferor voluntarily gives notice pursuant to § 507(a)(1). See §§ 1.507-1(b)(6) and 1.507-3(d). The transferor foundation is not required to provide such notice. In Situation 1, *P*'s dissolution under state law has no effect on whether *P* has terminated its private foundation status for federal tax purposes." The ruling also goes on to make several determinations under §§ 4941, 4942, and 4945.

Analysis:

RULING 1

In order to be exempt under § 501(c)(3) an organization must be operated exclusively for an exempt purpose. Section 1.501(c)(3)-1(c)(1). Rev. Rul. 64-182, *supra*, provides that the provision of grants to exempt organizations is a charitable purpose under § 501(c)(3). Here, you are providing a grant to an organization that is expected to be recognized as exempt under § 501(c)(3). The provision of grants to such an organization is in furtherance of your exempt purpose, therefore it does not create a substantial non-exempt purpose. The transfer of real property described by you to be made to Project does not affect your exempt status under § 501(c)(3).

RULINGS 2 and 3

Section 507(b)(2) describes a transfer from one private foundation to another private foundation according to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) describes the terms "other adjustment, organization, or reorganization" as including any partial liquidation or any other significant distribution of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term "significant disposition of assets to one or more private foundations" is defined by § 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year. Since you are transferring more than 25 percent of the fair market value of your net assets to Project, a private foundation, for no consideration, your proposed transfer is a significant disposition of assets that qualifies as a transfer under section 507(b)(2). Therefore, Project will not be considered a new organization, and it will assume your aggregate tax benefit in proportion to the fair market value of the real and personal property it receives over your total net asset value prior to the transfer. See Section 1.507-3(a)(2).

Pursuant to § 1.507-4(b) a private foundation that makes a transfer described in § 507(b)(2) is not subject to the tax imposed under § 507(c) with respect to such transfer unless the provisions of § 507(a) become applicable. Your transfer will constitute a significant distribution of assets described in § 507(b)(2). You have stated that you have not and will not notify the Secretary of your intent to terminate your status as a private foundation and that you have not ever either committed willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under Chapter 42 of the Code. Therefore, your proposed transfer of assets to Project under § 507(b)(2) will not terminate your private foundation status under § 507(a) and does not result in a termination tax imposed by § 507(c).

Under § 1.507-3(a)(9)(i) if a private foundation transfers all of its net assets to another private foundation which is effectively controlled by the same person or persons which effectively controlled the transferor private foundation, the transferee private foundation is treated as if it were the transferor. Here, you are transferring less than all of your net assets, so Project is not treated as you

for all private foundation purposes. Instead, Project will be treated as possessing your attributes and characteristics which are described in §§ 1.507-3(a)(2), (3), (4), and, to the extent applicable, (6) and (8)(ii).

RULING 4

Your § 507(b)(2) transfer of assets to Project is a grant to Project for capital endowment purposes. Because Project is not treated as you under § 1.507-3(a)(9), the transfer is a taxable expenditure under § 4945(d)(4) unless you comply with the expenditure responsibility requirements of § 4945(h). Your transfer to Project will not be considered a taxable expenditure as long as you exercise expenditure responsibility over the transfer in accordance with §§ 4945(h) and 53.4945-5(c)(2). Section 53.4945-5(c)(2) requires the grantee to make annual reports for the year in which the grant is made and the immediately succeeding two years. *You represent that Project will make such annual reports for the year in which the grant is made and the immediately succeeding two years.*

RULING 5

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Sections 4941 and 1.507-3(a) determine whether the proposed transfer of part of your assets to Project will constitute an act of self-dealing between a private foundation and its disqualified persons, as defined in § 4946. Under § 53.4946-1(a)(8), a "disqualified person" does not include organizations that are exempt under § 501(c)(3). Any benefit to your foundation managers is incidental and tenuous under the circumstances. Therefore, your transfer of assets to Project is not an act of self-dealing assuming that Project is recognized by the Service as an organization exempt from tax under § 501(c)(3).

RULING 6

Any distribution for a 170(c)(2)(B) purpose and the expenses associated therewith will be a qualifying distribution with two exceptions. Section 4942(g)(1). One of those exceptions is when an organization distributes assets to another organization that is controlled, directly or indirectly, by the same persons. *Id.* Where both organizations are controlled by the same persons the two organizations must follow the requirements found in § 4942(g)(3).

Under section 53.4945-6(b)(2) of the regulations, legal, administrative and other expenses incurred by a private foundation are not taxable expenditures if the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable depends upon the facts and circumstances of a particular case. Thus, your payment of such expenses, assuming that you can demonstrate ordinary care and prudence, will not constitute a taxable expenditure under § 4945.

Rulings:

1. The proposed transfer will not affect your tax-exempt status under § 501(c)(3).

2. The proposed transfer will qualify as a transfer described in § 507(b)(2) so long as Project is recognized as a private foundation by the Service. Further, Project will not be treated as a newly created organization. Project will be treated as possessing your tax attributes prior to the transfer only to the extent provided in § 1.507-3(a)(2), (3), (4), (6) and 8(ii).
3. The proposed transfer will not cause a termination of your private foundation status under § 507.
4. The proposed transfer will not constitute a taxable expenditure within the meaning of § 4945 provided you exercise the appropriate expenditure responsibilities. For purposes of the proposed transfer you need only exercise the limited form of expenditure responsibility required under § 53.4945-5(c)(2).
5. The proposed transfer will not constitute an act of self-dealing prohibited by § 4941 as to you, your officers and directors, or Project so long as Project is recognized as exempt by the Service.
6. The reasonable legal, accounting, and other expenditures incurred by you to effectuate the proposed transfer will not be treated as taxable expenditures under § 4945 so long as the transfer itself is not a taxable expenditure under § 4945, and your expenses for the proposed transfer will be treated as qualifying distributions under § 4942 to the extent reasonable and to the extent the requirements under § 4942(g)(3) are met.

This ruling is contingent upon Project receiving a favorable determination letter from the Internal Revenue Service stating that Project has been recognized as an organization described in § 501(c)(3).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Specifically, this ruling does not reach any conclusion as to the qualifying distribution status of your proposed transfer under § 4942(g)(3). Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437